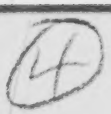

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CHARLES ELMORE CROPLEY
CLERK

Supreme Court of United States

OCTOBER TERM, 1942
No. 259

IN THE MATTER OF KENTUCKY FUEL GAS CORPORATION, Debtor, No. 991-B.

H. CLYDE REEVES, Commissioner of Revenue of the Commonwealth of Kentucky, Intervening Petitioner, - - *Petitioner.*

vs.

BEN WILLIAMSON, JR., Trustee of the Kentucky Fuel Gas Corporation.

BRIEF FOR TRUSTEE, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

ROBT. T. CALDWELL,
PORTER M. GRAY,
COUNSEL FOR TRUSTEE OF INLAND GAS CORPORATION,
Respondent.

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Decisious of the Courts Below.

The opinion of the District Court, Eastern District of Kentucky, is reported in 37 Federal Supplement, 625, and the decision of the Circuit Court of Appeals, Sixth Circuit, is reported in 127 Federal Reporter, 657.

STATEMENT.

The Commissioner of Revenue of the State of Kentucky has petitioned for a Writ of Certiorari, to review the decision of the Circuit Sourt of Appeals which affirmed a judgment of the District Court invalidating

an attempted assessment of United States Postal Savings Certificates for State taxes.

The material facts were presented to the District Court by stipulation appearing in the transcript. The District Court's conclusions of law, upon which judgment invalidating the assessment was entered, are as follows:

"1. Postal Savings Certificates are 'obligations of the United States' exempted by Congress from State and other local taxation by the provisions of Section 3701 of the Revised Statutes of the United States (31 USCA, Sec. 742).

2. The Postal Savings System is, as now constituted, a governmental financing agency and, as such, the postal savings certificates issued by it are exempt from taxation under the Constitution of the United States.

3. Taxation by the State of Postal Savings Certificates, or the savings deposits represented thereby, at the rate of 50c per $100.00 of principal amount would constitute an unconstitutional burden on its operations."

ARGUMENT.

I. THE CERTIFICATES ARE EXEMPT UNDER SEC. 3701, REVISED STATUTES.

The first question presented is whether these interest-bearing Certificates, to the payment of which "The faith of the United States is solemnly pledged" as set out in the face of the certificates and as is required by the Act of Congress under which they are issued, are an "obligation of the United States" and, hence, ex-

pressly exempted from State taxation by Section 3701 of the Revised Statutes. If so, it is, of course, unnecessary to determine whether they are also exempt under the Constitution independently of any Congressional enactment.

The Federal Statutes involved are as follows:

Title 39, U. S. C. A., Sections 751 to 769, inclusive, as amended, under which Postal Savings Depositaries are conducted and under which these certificates were issued.

Title 31, U. S. C. A., Section 742, exempting all stocks, bonds, Treasury notes and "other obligations of the United States", from taxation under State, municipal or local authority.

Title 31, U. S. C. A., Section 425, removing the exemption from State taxation in certain cases.
Title 31, U. S. C. A., Section 757c(e), further regulating the withdrawal of Postal Savings deposits.

A copy of the form of Certificate involved is appended to this brief. Section 3701 of the Revised Statutes (31 USCA, Sec. 742), is as follows:

> "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States shall be exempt from taxation by or under State or municipal or local authority."

In the petitioner's brief, pages 28 to 35, inclusive, there is presented a somewhat ingenious theory that in enacting Section 3701, in the year 1894, Congress must have had in mind seven existing Acts enacted during the period from 1862 to 1870, each of which specifically exempted some particular form of indebtedness authorized by that Act, and, hence, counsel conclude that "there was a complete lack of Congressional intent to

make R. S. 3701 cover more than these seven acts from whence it came"; although the 1894 Act itself contains no such intimation but on its face confers a general and unqualified exemption in favor of "all other obligations of the United States" except where Congress shall affirmatively subject a particular obligation to such taxation.

As no Court, during the forty-seven years that Section 3701 has been in effect, has ever emasculated it in the manner now proposed by the Kentucky Tax Commission, it does not appear necessary to debate that theory here.

The real question presented is whether Postal Savings Certificates are "other obligations of the United States" within the meaning of the Act. The only decision of the United States Supreme Court cited by petitioner on this point, Hibernia Savings & Loan Society v. City and County of San Francisco, 200 U. S. 310, 50 L. Ed. 495, on more careful inspection will be found to be authority for the exemption of these certificates from State taxation, when the facts there involved are compared with the case at bar. There the tax was applied to two ordinary Treasurer's checks issued in payment of some accrued interest due the payee. The Court, after citing what is now Section 742 of Title 31 exempting obligations of the United States, held that,

> "The basis of this exemption is the fact that a tax upon the obligations of the United States is virtually a tax upon the credit of the government, and upon its power to raise money for the purpose of carrying on its civil and military operations. The efficiency of the government service cannot be impaired by a taxation of the agencies which it employs for such service, and, as one of the most

valuable and best known of these agencies is the borrowing of money, a tax which diminishes in the slightest degree the value of the obligations issued by the government for that purpose impairs pro tanto their market value."

After citing authorities in support of this rule, the Court further held that,

"The principle, however, upon which this exemption is claimed, does not apply to obligations such as checks and warrants, intended for immediate use, and designed merely to stand in the place of money until presented at the Treasury, and the money actually drawn thereon. In such case the tax is virtually a tax upon the money which may be drawn immediately upon presentation of the checks."

And also,

"But where checks are issued payable immediately, they merely stand in the place of coin, which may be immediately drawn thereon. As observed by the court below, the checks were, for all practical purposes, the money itself."

The Court then cited the later Act, which is now U.S.C.A. Title 31, Sec. 425, and which removed the tax exemption from

"circulating notes of national banking associations and United States legal tender notes, and other notes and certificates of the United States, payable on demand, and circulating, or intended to circulate, as currency, etc."

and held that,

"Although the checks in question were not intended to circulate as money, and therefore do not fall within the letter of the statute, the reasons that apply to that class of obligations we think

> apply with equal force to checks intended for immediate payment, though not intended to circulate as money. While the checks are obligations of the United States, and within the letter of Sec. 3701, they are not within its spirit, and are proper subjects of taxation."

It is noted that the Treasury checks there involved were in no sense a means of "raising money for governmental purposes." To the contrary they were used solely as a means for the immediate *disbursement* of money by the Government, being held by the Court to be "for all practical purposes, the money itself."

On the other hand, the Court will take judicial notice that the Postal Savings system is now one of the important means by which the Government raises money, at a low rate of interest, for the purpose of carrying on its various governmental functions. The Certificates bear interest the same as other Government securities, and the fact that they are not actually "intended or immediate use" rather than as a means of Federal financing is further indicated by the provision of Sec. 757 that the interest shall be allowed and entered "once in each year", the certificates themselves bearing a column for the entry of interest credits up to ten years.

The Postal Savings Depositories Act also provides (Title 39 U. S. C. A., Sec. 766), that

> "The faith of the United States is solemnly pledged to the payment of the deposits made in postal savings depository offices, with accrued interest thereon as herein provided",

and the Certificates themselves bear the representation on their face that

"The Faith of THE UNITED STATES OF AMERICA Is Solemnly Pledged to The Payment of Deposits With Accrued Interest, Act of June 25, 1910."

Applying the rule announced in the Hibernia case, and the reasons for the rule stated in that opinion, it is evident that these certificates are obligations of the United States within the meaning of Section 3701 and, hence, exempt under the statute.

The only Federal cases dealing specifically with Postal Savings which we find are Farley v. Albers, 112 Fed. (2d) 401, from the Circuit Court of Appeals for the District of Columbia, and Leka v. United States, 69 Ct. of Cl. 79, both cited by petitioner, and U. S. v. Stewart, 30 Fed. Supp. 200, from a Nevada District Court.

In the Stewart case the District Court had before it solely a question of jurisdiction, and held that the local State courts have jurisdiction of any controversy between parties claiming the ownership of Postal Savings deposits, on the ground that "such deposits are trust funds and not the property of the United States", upon authority of the Court of Claims decision in the Leka case. The question of whether Postal Savings certificates are an "obligation" of the United States was not discussed.

The case of Leka v. United States, 69 Court of Claims, 79, relied on by petitioner, is apparently based on an erroneous assumption as to the present workings of the Postal Savings System, as the opinion states that the deposits "are to be held within the State or Community where the deposit was made", and that no part of the fund went into the Treasury of the United

States. That the situation so assumed and made the basis of the ruling of the Court of Claims in the Leka case no longer exists is indicated by the System's own report and by the Statement of the Ashland postmaster which appear in the Stipulation of Facts.

The later holding of the Circuit Court of Appeals for the District of Columbia, in Farley v. Albers, supra, (Certiorari denied, 85 L. Ed. 60), is directly to the contrary. The question directly presented was whether the Postal Savings funds were "funds of the United States Government" and, hence, whether a suit involving them could be maintained without the United States itself being a party. After summarizing the Act, and quoting in its entirety the provision whereby the Government may borrow 95% of the fund, the Court held that,

> "Taken as a whole, the system constitutes a part of both the postal and fiscal operations of the government. Profits are treated as postal revenue, and the fund is held in reserve for emergency use of the government and to facilitate government refinancing operations by the purchase of government bonds. It is safeguarded as other public moneys, and the obligation to the depositors is the pledge of the United States."

And also,

> "The statute, under which it was received by the United States, gave the President the right to invest all or any part of it when in his judgment the general welfare and public interest required. The credit of the United States was pledged for its repayment. This, at the very least, created as between depositor and government the relationship of debtor and creditor, and gave the United States

full control of and full responsibility for its disposition."

The Circuit Court's holding in the Albers case to the effect that these Postal Savings certificates are a form of obligation of the United States, together with the construction of Section 3701 adopted by the Supreme Court in the Hibernia case, clearly brings these certificates within the exemption conferred by that statute and demonstrates the correctness of Judge Ford's ruling upon that ground.

II. POSTAL SAVINGS CERTIFICATES ARE EXEMPT UNDER THE CONSTITUTION.

As stated in the District Court's opinion in the present case,

> "We need not inquire whether postal savings deposits are embraced within the terms of section 3701 of the Revised Statutes (31 USCA, 742) for neither declaration of exemption by Congress nor the absence thereof would add to or detract from complete immunity existing by virtue of the necessary implications of the Constitution."

It is also unnecessary here to go into any extended discussion of the general rule, as announced in recent decisions of the United States Supreme Court, with respect to the extent to which Federal agencies and their employees may be constitutionally subjected to State or local taxation, since we are concerned here only with the degree of exemption extended to Federal financing agencies in particular.

The present rule as to the extent to which a Federal administrative agency and its employees may be subpected to State and local taxation is announced by the

Supreme Court in Graves, et al. v. New York Ex Rel O'Keefe, 306 U. S. 466, 83 L. Ed. 927, which upheld the right of a State to impose a non-discriminatory income tax upon the salary of an employee of the Home Owners' Loan Corporation.

The opinion points out that a non-discriminatory tax on the income of an individual employed by the Federal agency does not directly burden the operation of the agency itself; that the same rule applies in this connection to the taxation of State salaries by the Federal Government and taxation of Federal salaries by State Governments, and regardless of whether the taxpayer is an employee or an officer, and that,

> "In on case is there basis for the assumption that any such tangible or certain economic burden is imposed on the government concerned as would justify a court's declaring that the taxpayer is clothed with the implied constitutional tax immunity of the government by which he is employed."

There is nothing in the Graves opinion which modifies the long-established rule as to the immunity of all Federal financing agencies from interference with their functions by State or local taxation which exists under Section 8 of Article 1 of the Constitution. Likewise, the numerous decisions cited under Topic IV of petitioner's brief, pages 35 to 48, deal with various other types of taxes not involving this question.

The extent of the immunity of an instrumentality of Federal financing, and the necessity for such exemption, is stated by the Supreme Court in the Hibernia case, supra, as follows:

> "The basis of this exemption is the fact that a tax

upon the obligations of the United States is virtually a tax upon the credit of the government, and upon its power to raise money for the purpose of carrying on its civil and military operations. The efficiency of the government service cannot be impaired by a taxation of the agencies which it employs for such service, and, as one of the most valuable and best known of these agencies is the borrowing of money, a tax which diminishes in the slightest degree the value of the obligations issued by the government for that purpose impairs pro tanto their market value."

One of the more recent Supreme Court decisions which reaffirms the rule is Missouri Ex Rel Missouri Ins. Co. v. Gehner, 281 U. S. 313, 74 L. Ed. 870, holding that a State may not subject one to a greater burden upon his other taxable property by reason of his ownership of tax-exempt government securities and that,

> "It is elementary that the bonds or other securities of the United States may not be taxed by state authority. That immunity always has been deemed an attribute of national supremacy and essential to its maintenance. The power of Congress to borrow money on the credit of the United States would be burdened and might be destroyed by state taxation of the means employed for that purpose. As the tax-exempt feature tends to increase and is reflected in the market prices of such securities, a state tax burden thereon would adversely affect the terms upon which money may be borrowed to execute the purposes of the general government."

Tacitly conceding that a State cannot tax a Federal instrumentality for the raising of funds for governmental purposes, the Commissioner takes the position that the Postal Savings system is not a means of Federal financing but is simply a means of providing

local banking facilities to those numerous communities throughout the country who, at the time the original Act was passed in 1910, were without available capital or banking facilities. The brief, pages 18 to 22, inclusive, quotes at length from the platforms of the two parties, from the debates in Congress and from statements by succeeding Presidents, to the effect that under then existing conditions (which followed the panic of 1907 and before the enactment of a Federal Deposit Insurance Act), money deposited in local banks would be withdrawn and centralized in the financial centers and that the Postal Savings system would remedy this situation by localizing lendable funds and keeping them in circulation throughout the producing regions of the entire country.

It may be that such was the opinion of those participating in the Congressional debates in 1910, when the original Act was passed. However, Congressional debates are not of assistance to the Court in construing a statute unless the language of the Act itself is ambiguous or incomplete. They cannot be invoked to nullify an express provision of the statute as enacted, or as subsequently amended.

Section 759 of Title 39, U. S. C. A., subsequently enacted in 1912 and as amended in 1916, specifically provides for the use of the Postal Savings system as an agency for Federal financing, it being provided that,

> "When, in the judgment of the President, the general welfare and interests of the United States so require, the Board of Trustees may invest all or any part of the postal savings funds, except the reserve fund of 5 percentum herein provided for, in bonds or other securities of the United States."

The Act as amended having thus constituted the entire Postal Savings system, to the extent of 95% of its funds, into an available financing agency of the United States, its certificates would doubtless be beyond the reach of State or local taxation even if the Federal Government had not yet actually availed itself of the services of this fiscal agency. However, it is unnecessary to consider that question here because the Stipulation of Facts which has been filed by the parties shows that the Government has already invoked that power to make use of the System as a means of Federal financing and has actually borrowed practically every dollar available from that source. As of the end of the past fiscal year, on June 30, 1940, the report of the System which is incorporated in the Stipulation shows that there has accumulated in this fund more than one and one-third billion dollars, of which over 92% (and 95% of the balance to credit of the depositors) has been invested in securities of the United States.

These admitted facts show that the Postal Savings system, under the Act as now amended, is both legally and actually not only an agency of Federal financing, but a very substantial one.

This being true, it follows that the certificates issued by it as an incident to this method of Federal financing are exempt from State taxation "which diminishes in the slightest degree the value of the obligations" issued for that purpose, as held in the Hibernia case.

As pointed out in the Gehner opinion, the tax-exempt status of Federal securities renders them marketable and any State tax thereon "would adversely affect the terms upon which money may be borrowed to execute the purposes of the general government."

Applying this rule to the facts of the present case, it is obvious that this source of Federal financing, through which the Government is now borrowing one and one-third billion dollars, would be adversely affected if these Certificates which bear only 2% interest were subjected to the tax of 50c per $100.00 here involved, which would be equal to a gross income tax of 25% on the lender's return from them. Incidentally, this would be the situation only so long as the Kentucky taxing authorities do not procure the State Legislature to raise the present rate of 50c on intangibles, or modify or remove the present State exemption of intangibles from local taxation. It is a matter of common knowledge that formerly Kentucky subjected intangibles to both State and local taxation, the aggregate rate of which substantially exceeded the entire 2% return from these certificates, and also that at each session of the Legislature bills are put forward both to raise the existing State rate and to modify the existing exemption from local taxation. Also, any holding that these Postal Savings certificates are subject to taxation in Kentucky necessarily would subject them to whatever rates of State and local taxation are applicable to intangibles in any other State. It does not require argument to demonstrate that such a holding would directly and substantially impair the operation of this Federal agency and the system of governmental financing which is now conducted through it.

The opinion of the Circuit Court of Appeals unanimously affirms the holding that the exaction is an unconstitutional burden upon the financial activities of the Federal Government, within the holding of the cases cited in the opinion.

III. THE PROPOSED TAX IS DISCRIMINATORY.

As a third, and additional, ground for invalidating the State tax here involved the District Court held that it is discriminatory. For the reason that the tax is clearly invalid upon both of the other two grounds assigned by the Court, in that the certificates sought to be taxed are exempt under Section 3701 of the Revised Statutes and also that this means of Federal financing is constitutionally exempt from such taxation, we do not believe that any extended discussion of this additional ground of invalidity is here necessary.

The District Court's opinion appearing in the transcrip summarizes the facts out of which the discrimination exists and also distinguishes the case of Madden v. Kentucky, 309 U. S. 83, 84 L. Ed. 590, on authority of which appellant sought to justify the admitted discrimination involved. Upon this the Court holds,

> "Thus by applying to them the so-called 'catch-all' provision of the statute, the State asserts the right to tax postal savings deposits at five times the rate imposed upon deposits in banks of the state.
>
> While the direct burden of the tax falls upon the owners of the intangible property rights evidenced by United States Postal Savings Certificates, it can scarcely be doubted that the effect of laying a tax load upon them which is substantially heavier than that imposed upon the holders of the same type of property within the state, represented by deposits in banks, will inevitably tend to curtail the use, cripple the growth and retard the development of the postal deposit facilities and thus injuriously affect the means employed by the Government to accomplish its purposes. See, Farmers & Mechanics Savings Bank v. Minnesota, 232 U. S.

516. No extraordinary gift of prophecy would seem to be required to forecast the ultimate fate of the Government's system of postal savings deposits if such discrimination against it by the states or other local taxing authorities be permissible.

The opinion of the Supreme Court in Madden v. Kentucky, 309 U. S. 83, which the state insists is authority sustaining the validity of such a variation in tax rates, even when affecting governmental agencies, deals only with the question under the due process, equal protection and privileges and immunities clauses of the Fourteenth Amendment. It has no application to or bearing upon the problem of inter-governmental taxation or the constitutional safeguards under which governmental functions are made secure from interference."

The majority opinion of the Circuit Court also affirms this additional ground of invalidity found by the District Court, in a detailed analysis of the authorities which fully covers the question.

It is respectfully submitted that the findings and judgment of the District Court invalidating the assessment, and the Circuit Court's affirmance of that pudgment, were correct and that the petition for a writ of certiorari should be denied.

Respectfully submitted,

ROBT. T. CALDWELL,

PORTER M. GRAY,

COUNSEL FOR TRUSTEE OF INLAND GAS CORPORATION,

Respondent.

500 500

POSTAL SAVINGS SYSTEM
The Faith of the
UNITED STATES OF AMERICA
Is Solemnly Pledged To The Payment of Deposits With Accrued Interest

Act of June 25, 1910

ASHLAND, KENTUCKY
Depository Office

1114
Serial Number

Name of Depositor

POST OFFICE DEPARTMENT

Date of Issue

Account Number

FIVE HUNDRED DOLLARS

Date When Interest Begins

Not Transferable
Not Negotiable

This certifies that the Sum of Five Hundred Dollars Has Been deposited with the Postal Savings System and Will be payable to the Depositor at the above named Depository Office with Interest at the rate of two per cent per annum payable annually on the presentation of this certificate properly endorsed.

Series of 1917

James A. Farley,
Postmaster General.

500 500

Reverse Side

Received the amount of this certificate and
$..... interest due thereon.

.....

The depositor must not indorse this Certificate until it is presented at the post office for payment.

INFORMATION FOR DEPOSITOR.

1. Before accepting this Certificate the depositor must see that the amount for which it is issued is correct.
2. If this certificate is lost, the depositor should immediately notify the postmaster at the post office where issued.
3. Certificates begin to draw interest from the first day of the month following the month in which issued.
4. The postmaster will stamp in the spaces below the dates on which annual interest payments are made, deferred payments covering two or more years to be stamped separately in the spaces provided or the several years.

Number of Years	Total Accrued Interest	Interest Accruing Annually	Dates of annual interest payments of ten dollars each

(Schedule of interest, 1 to 10 years, follows).